



April 29, 2005

The Honorable Connie Mack
Chairman
Advisory Panel on Tax Reform
1440 New York Avenue NW
Suite 2100
Washington, DC 20220

The Honorable John Breaux
Vice Chairman
Advisory Panel on Tax Reform
1440 New York Avenue NW
Suite 2100
Washington, DC 20220

Dear Chairman Mack and Vice Chairman Breaux:

We are writing today to provide you with industry perspective as you embark on the task of reforming our federal tax system. The Computer & Communications Industry Association (CCIA) is one of the nation's major high technology industry organizations, representing key strategic segments of the world's broad technology and information industries.

CCIA represents large, medium and small companies in the high technology products and services sector, including computer hardware and software, electronic commerce, telecommunications and Internet products and services – companies with more than \$200 billion in annual revenues.

It is the computing and communications industries who some years ago took the \$ 200 storefront tax preparation visit and reinvented it into a \$ 20 self-prepared software product or online service. This advancement utilized the benefits of investment, innovation and robust competition to develop and deliver products and service experiences for Americans which not only simplified tax compliance, and put the consumer in charge of their own finances, but made tax preparation and planning a core part of individual, family and small business financial management in the American culture and economy.

We appreciate the opportunity to submit comments as the Panel deliberates on its learnings, conclusions and recommendations. We are reserving judgment and any associated comments about *specific* tax system alternatives you may be considering. We may share comments at a future point in the public policy dialogue regarding the substance of specific tax reform proposals that may be made over time. But in the broader context, as you consider the many options for reforming our tax system, we want to urge that the Panel keep in mind the *appropriate role* of the government in this sector overall, and the important role of American citizens and small businesses as taxpayers. Over the years, there have been various movements on the state and federal level to have government take over more and more of the taxation process, moving from tax administration, revenue collection and compliance into a more cradle-to-grave role beginning with original tax preparation through audit and collection through enforcement. In large part, those ill-conceived movements to broaden the mission and role of the tax agency have been thwarted by a number of factors, including taxpaying-consumer disinterest and mistrust for the tax collector also serving as tax preparer, a range of concerns about privacy and security, and a host of other factors.

One example of such a costly failure is the California Franchise Tax Board's "ReadyReturn" program of this past tax season, in which the FTB "pre-prepared" income tax returns for California taxpayers on the revenue department's computer systems and sent out a written determination and bill to selected households. Only about 5,500 taxpayers accepted the government's reckoning – which is only halfway to the goal the agency had set of 10,000 first year voluntary participants, and a very small percentage of the 50,000 solicitation notices that were sent out.

Government programs like "ReadyReturn" and other Return-Free initiatives are ill-advised for a number of reasons. Putting aside the utter lack of consumer-taxpayer interest or demand, there are considerable privacy and security concerns associated with the government operating such systems, including the inherent conflict of interest between the tax agency's mission to maximize revenue collections and the citizen's objective of minimizing their personal tax liability. The most obvious warning flag for the public risk of setting up such a direct conflict of purpose is in the extensive content of the several years of Congressional hearings and oversight investigations into IRS abuses including quotas, harassment, and a broad range of other serious allegations and findings.

Today, as the advantages and convenience of electronic government tax services are being promoted by some, consumers are generally not being told that one of the motivations behind ideas like Return-Free is to maximize revenue from taxpayers. Moreover, this objective is sufficiently important that it is being pursued without regard to the taxpayers' rights, which in California, for example, explicitly include the individual taxpayer right to self-assessment. Playing on the supposed convenience factor, and exploiting the consumer's desire to 'not be bothered' with preparing their own taxes, there is no way to know if the government tax agency preparing the return is considering – or even intentionally ignoring – all of the legal deductions that individual taxpayers are potentially entitled to. There is also no public education about the undiminished liability to the taxpayer of accepting the return prepared by the government – for example, in the

case of California and their Return-Free or “ReadyReturn” project, unlike private tax preparation service providers, the government tax agency does not accept any shared responsibility for the accuracy of the return, for which the participating taxpayer is solely liable even though they did not prepare it. To correct this fundamental defect in the system would involve having government take on a commercial performance and accuracy responsibility which is wholly foreign to their normal agency culture, and it would pit one part of the tax agency against another, since any subsequent audit of the return by government would involve its examination by the same tax agency that prepared it.

But it is perhaps the revenue enhancement character of Return-Free that makes it so attractive to revenue and budgetary agencies alike. Nevertheless, there is no public disclosure of the econometric modeling and revenue impact analyses being used by governments to project the revenue enhancement expected from the tax agency taking on the original return preparation function in the taxation process. What we do know is that in California, the State Controller who chairs the Franchise Tax Board has explained that given a projected \$ 6 Billion tax revenue shortfall to the state treasury, Return-Free was conceived as a key element of the strategy to close that gap. However, testimony from the FTB’s expert witness at their hearing on the initiative in August 2004 explained that Return-Free cannot reach income that is truly unreported, such as that which may be earned by the self-employed, or which may come ‘under-the-table’ from the cash economy, tip income, and more. Instead, Return-Free can only capture income already reported on W-2 wage statements from employers or 1099 statements from banks, brokers and others. Therefore, the assumptions about increased revenues must come from these wage earners, most of who already comply with the tax system. Given that the primary mission of the tax agency *is* to maximize revenue, the government tax preparation systems are likely to err on the side of fewer or no legal deduction. There is also an intimidation factor, particularly among the less well educated, foreign-born or non-native speaking Americans, lower income and minority populations, and the elderly. Taking all of these factors together, tax systems that include a Return-Free compliance strategy will, by definition, serve as *a backdoor tax increase* to many who might accept it and be unaware of the perfectly legal deductions they would otherwise be entitled to.

Indeed, U.S. tax agencies that have considered the construction of Return-Free systems have pointed to some of the worst failures of such systems overseas as examples of what they are trying to emulate. For instance, California’s FTB has repeatedly cited the United Kingdom’s “self-assessment online” tax service and Return-Free tax system as their model, notwithstanding the fact that Britain still has a significant tax compliance problem, largely due to the public not accepting Inland Revenue’s Self-Assessment Online service, which enjoys only a 3% public take-up rate. And although some years ago Britain adopted a national objective of achieving 50% electronic filing, just one year ago that goal was reduced to 25%. This failure is especially noteworthy because the system has cost the Crown several hundred million pounds since its inception, and it was reported within the last year by the Chancellor of the Exchequer in a report to the House of Commons that the cost of the system still exceeds \$50 per return. The government has also suffered substantial embarrassment as the system has had repeated serious problems

relating to privacy and security, and at one point had to be taken down, offline, for more than 30 days within the tax season when it was discovered that some taxpayer's personal income and tax information was being disclosed to other taxpayers online when data was incorrectly transferred among different peoples' tax returns. This track record is hardly one to emulate for adoption in the United States.

More successful have been instances in the tax preparation arena where government has either partnered with – or left it to – the vibrant, competitive private high-tech sector to help and empower consumers to manage their own personal finances, of which tax planning is a vitally important element.

On the partnership front, one prominent example is the success of the public-private partnership called the Free File Alliance, which this year helped U.S. taxpayers hit a 50% e-filing rate for the first time in the United States, well along the path to the national goal of 80%. Since the Alliance's inception, 20 states have followed suit and created their own partnerships based on this model in order to serve state taxpayers as well. Like the federal model, the state Free File Alliances operate at no cost to the public treasury or to the individual user.

Despite the contribution of these programs and the lack of demand from taxpayers for a government solution, certain state revenue agencies have continued to pursue costly and labor-intensive government-run systems in various forms. Costly, typically unsuccessful programs such as this stand in sharp contrast to the overwhelming success of taxpayer-centric solutions like the Free File Alliance.

Whatever form the Advisory Panel's final recommendation takes, the high technology industry can develop and make available easy, convenient, time-saving and low-cost front-end compliance tools for the taxpayer. Whether your recommendation is a reformed version of the income tax system, a national sales tax, a VAT, or a hybrid tax policy idea, our members have the ready ability to build and provide the innovative tools needed for individual taxpayers and small businesses to comply easily and inexpensively.

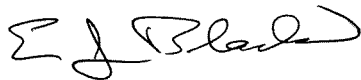
Some of our member-companies have been serving taxpayers for decades and compete to consistently provide the best product for simplifying the consumer tax experience. The consumer benefits from the latest security and privacy technology, but also enjoys products that are constantly evolving and improving to meet their needs in a more efficient and effective way. Continuous usability testing, coupled with ongoing investment in service improvements and product simplification, has made tax preparation and planning software an essential element of personal and small business financial management, giving the individual citizen and small business control over their own finances. We hope that the Advisory Panel's considerations, in terms of tax processing, will focus on the back-end functions which only government can perform, such as how the returns will be processed in any future tax system, as well as how collection processes and compliance enforcement will be managed.

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A solution that takes advantage of the technology industry's capabilities ensures that the taxpayer's individual right to participate in our voluntary compliance system, retaining all of their rights in the tax preparation process, are carefully preserved. The importance of empowering the citizen should be a principal concern as you consider potential reform, and it is critical that the tax reform effort does not move in a direction that reduces the role of citizens and small businesses in the taxation process, as it is one of the few ways in which the public has awareness of, and retains accountability for, their own government.

Citizen empowerment is not reflected around the world in the tax systems foisted upon those who live in other nations. As is said about the U.S. court system, it may not be perfect, but it is the best, fairest and most protective of individual rights of any such system in the world. The same is true of the current relationship between the U.S. government and its taxpayers. It would be wholly inappropriate for the government to take away from the individual the opportunity to engage in the taxation process. We urge that whatever improvements and changes the Advisory Panel proposes for the future of the tax system, the empowerment of our citizenry, and resulting accountability of government, must not be diminished.

Sincerely,

A handwritten signature in black ink, appearing to read "E J Black", with a stylized flourish at the end.

Edward J. Black
President & CEO
CCIA